



Alerts

Illinois Appellate Court Reviews the Rights of a Lender as a Mortgage Holder Under a Standard Mortgage Clause in an Insurance Policy

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Hinshaw Alert

A recent decision by the Illinois Appellate Court for the First District (*Old Second National Bank v. Indiana Insurance, Co., et al.*) resolves the conflict between the rights of a lender, named as a mortgage holder in an insurance policy issued to insure a building taken as collateral by the lender, with those of an insurance company relying on a vacancy clause to deny coverage under the policy.

The court ruled that the lender would collect on the policy as long as it complied with its obligations under the policy even if the insurance company is not liable to pay the insured. The lender recovered even though the policy provided that the insurance company would not be obligated to provide coverage for vandalism or theft if the property had been vacant for more than 60 consecutive days. The property in question was vacant when the policy was issued and continued to be vacant through the time of the vandalism.

In 2007, a vacant industrial property located in Askum, Illinois was acquired by Brother Future Holdings, LLC (Brother) which intended to redevelop the property. In August of that year, the mortgage on the property was transferred to Old Second National Bank (Old Second).

In June of 2008, Brother applied for insurance on the property through Assurance Agency (Assurance), which could solicit and process applications for Peerless Indemnity Insurance Company (Peerless). The application submitted by Assurance stated, incorrectly, that the building (comprised of 3,990 square feet) was 100% owner-occupied. In fact, the building had been vacant since 2005, and the total square footage was in excess of 35,500 square feet.

The policy was automatically renewed in June of 2009. In July of 2009, Old Second requested that Assurance add Old Second to the policy as a mortgage holder. The court reported that:

Assurance sent Old Second a document entitled "Evidence of Property Insurance," which stated that the identified insurance "has been issued, is in force, and conveys all the rights and privileges afforded under the policy...and is subject to the premiums, forms and rules in effect for each policy period." The document further provided that Old Second would be given 30 days' notice in the event of the policy's termination and would be informed of any changes to the policy that would affect its interest.

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Vandals broke into the property in December of 2009, damaging the property and stealing various items causing losses totaling approximately \$2.27 million.

The insurance policy provided that the property would be deemed vacant unless 31% of the property was rented out or used by the owner. The policy further provided that if the property was deemed vacant for more than 60 consecutive days, Peerless was not obligated to pay for damages that occurred due to vandalism or theft.

The policy provisions with respect to Old Second, however, stated that Peerless could only deny Old Second's claim because of the actions of Old Second or because Old Second failed to comply with the terms of the policy.

Peerless informed the parties that because the property had been vacant since 2005, coverage would be denied.

The circuit court granted summary judgment in favor of Old Second concluding that as a matter of law, Old Second was entitled to coverage under the mortgage clause.

Peerless appealed arguing that because the loss was due to vandalism and theft to a building that had been vacant for more than 60 consecutive days, no coverage was available to Old Second.

In upholding the trial court's decision, the appellate court first distinguished between a "simple" or ordinary mortgage clause and a "standard" mortgage clause, noting that the former treats the lender as an appointee eligible to receive insurance proceeds only to the extent of its interest stated in the policy with mortgagee possessing no greater rights than the insured/debtor.

The court in determining that the mortgage clause in question was a "standard" mortgage clause, stated:

The "standard" mortgage clause, more broadly, forms a separate and distinct contract between the insurer and the mortgagee, the effect of which is to shield the mortgagee from being denied coverage based upon the acts or omissions of the insured or the insured's noncompliance with the terms of the policy. **(Citations omitted)** Under the "standard" mortgage clause, the terms and conditions of the insurance policy are deemed to apply equally to the loss payee and the insured, but the loss payee is liable only for its own breaches. **(Citations omitted)** A central purpose behind the clause is to protect the mortgagee from the whims of the debtor **(Citations omitted)**, and is rooted in a recognition that the mortgagee typically "has no control over a mortgagor's representations and no knowledge or means of knowledge of facts upon which the mortgagor's representations are based. **(Citations omitted)**.

The court then reviewed decisions from New York and Pennsylvania that involved a mortgage clause and vacancy provision similar to the ones before the court. The court determined that in order to best effectuate the language and purpose of the standard mortgage clause, the lender should not be denied coverage as long as the loss did not result from the lender's breach of the policy. The court reasoned that holding otherwise "would place the mortgagee in the untenable position of having to guarantee the regular occupation of the premises, effectively placing it "at the whim" of the insured."

The court indicated that the record demonstrated that Old Second had complied with the terms of the policy that applied to the mortgagee, noting that:

The only requirements placed upon Old Second under the mortgage clause were that it: 1) pay any premiums due under the policy at Peerless' request, and there is no evidence that any such premiums were either due or requested; 2) submit a signed, sworn proof of loss within 60 days after receiving notice from Peerless of its failure to do so, and the record reflects that Old Second did submit a proper proof of loss; and 3) notify Peerless of any change in ownership, occupancy or substantial change in risk known to it.

As a consequence, the court affirmed the trial court's judgment and affirmed the trial court's order granting pre-judgment interest to Old Second.



For further information on this issue, please contact [Tim Sullivan](#), [Mike Morehead](#) or your regular [Hinshaw attorney](#).

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